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FINANCIAL
MANAGEMENT

Financial Control and System
Weaknesses Continue to
Waste DOD Resources and
Undermine Operations

Statement of Charles A. Bowsher
Comptroller General of the United States



Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today to present our views on the Department of Defense's (DOD) efforts to improve accountability and controls over operations. Given the vast amount of resources that are entrusted to DOD, it is imperative that the Department have effective financial management and internal control systems. As I testified before this Committee last July, our reports and testimonies over the last several years have disclosed widespread and significant problems with DOD's financial management operations, systems, and controls.¹

Recently, we have seen encouraging signs from DOD's new leadership, including frank admissions of financial management problems and a heightened interest in bringing about their resolution. In a February 1994 statement presenting DOD's fiscal year 1995 budget, the Secretary of Defense acknowledged "we need to reform our financial management. It is a mess, and it is costing us money we desperately need." That kind of leadership commitment is essential to correcting the problems I am going to discuss.

The severe shortcomings in DOD's financial operations that I will discuss today further demonstrate the importance of expanding the Chief Financial Officers (CFO) Act requirements that I addressed in February before this Committee.² Specifically, expanding and making permanent the requirement for audited financial statements in DOD, as well as for agencies governmentwide, is critical to ensuring basic accountability and to making available the facts needed to run our government more efficiently. As requested, I will focus my remarks on updating you on the status of DOD's progress in addressing problems in five important areas.

-- Contractor Overpayments

During the first 6 months of fiscal year 1993, DOD received \$751 million in payments returned by contractors. Our analysis has shown that such returns primarily represent overpayments made through breakdowns in government controls or errors. Weak controls over disbursements also permitted illegal payments-- such as \$3 million in fraudulent payments to a former Military Sealift Command supply officer.

-- Military Payroll

Improper Army payroll payments have resulted in an estimated \$7.8 million of debts owed to the government. Investigations to date have confirmed that six "ghost" soldiers and 76 deserters received unauthorized pay.

¹Financial Management: DOD Has Not Responded Effectively to Serious, Long-standing Problems (GAO/T-AIMD-93-1, July 1, 1993).

²Improving Government: GAO's Views on H.R. 3400 Management Initiatives (GAO/T-AIMD/GGD-94-97, February 23, 1994).

-- Unmatched Disbursements

DOD has identified approximately \$19 billion in unmatched disbursements. Such disbursements represent payments for goods and services which have not been matched with related obligations. Until this condition is corrected, errors or illegal acts may be more likely to occur and not be detected.

-- "M" Accounts

Continuing problems with DOD "M" account appropriations may have resulted in overexpending five "M" accounts by \$152.7 million as of the end of fiscal year 1993.

-- Defense Business Operations Fund

DOD has made some progress in improving DBOF operations; however, most previously reported problems with the Fund continue. Current prices charged to Fund customers do not reflect actual operating costs for the reporting period. In addition, DOD needs to assess whether the Fund needs to have a full-time director responsible for overseeing its implementation and day-to-day operations.

I will also provide our concerns on the need for a strategic plan to guide DOD's financial system improvement efforts under its Corporate Information Management initiative.

EFFORTS UNDERWAY TO IMPROVE
DETECTION AND COLLECTION
OF CONTRACTOR OVERPAYMENTS

A dramatic indicator of the adverse effects of poor controls over the disbursement process is the dollar value of payments returned to the government. Last July, we testified that the DFAS-Columbus Center received \$751 million from DOD contractors during the first 6 months of fiscal year 1993. Our report on those payments,³ which is being released today, shows that most of the payments were returns of contract overpayments.

Our examination of \$392 million of the \$751 million returned by contractors disclosed that about \$305 million, or about 78 percent, were overpayments. DFAS-Columbus overpaid contractors principally because it either (1) paid invoices without considering previous progress payments or (2) made duplicate payments. Other errors, such as government contractual errors, also contributed to the overpayments.

Underscoring our concern about the amount of overpayments is the fact that the vast majority of the overpayments we examined were

³DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, March 14, 1994).

detected by contractors, rather than as a result of existing DFAS controls. In any situation in which the government must rely on contractors rather than its own controls to detect and collect overpayments, the risk is greater that losses will result from undetected, or unreturned overpayments.

The DFAS-Columbus collection process also did not ensure prompt return of overpayments identified and reported by contractors. In some cases, contractors planned to return overpayments but were told to hold them until the contracts could be reconciled and demand letters issued. The standard demand letter allowed an additional 30-day grace period to return an overpayment before interest was assessed. The interest cost associated with these overpayments, even when they are returned, can be significant. To illustrate, for about \$240 million in returned overpayments for which we could determine the date the disbursement was made, we estimated the interest costs were about \$2.3 million. These overpayments were outstanding an average of 108 days, and about 40 percent were outstanding more than 90 days. DFAS-Columbus issued a policy in November 1993 requiring that contractors be asked to immediately return reported overpayments.

DFAS's primary method of detecting overpayments is through detailed examinations--known as reconciliations--of contracts with known or suspected problems. DFAS-Columbus has assigned about 130 personnel to conduct contract reconciliations. They reconciled 6,619 contracts in fiscal year 1993. However, as of December 1993, DFAS-Columbus officials had identified 6,603 "problem" contracts--contracts with payments exceeding available funds, or contracts with other problems, such as missing payments or other pertinent contractor information--that had not been reconciled. We understand that DFAS is hiring additional personnel to deal with the backlog of contracts that have not yet been reconciled.

In addition to its own reconciliations, DFAS engaged a public accounting firm to reconcile selected "problem" contracts. For the period of October 1990 through November 1993, the accounting firm reconciled approximately 4,300 contracts and identified the following.

- Contractors owed about \$208 million to the government, and an additional \$52 million in possible contractor debts was still under review in November 1993.
- The government owed about \$61 million to contractors.

Based on the accounting firm's reconciliations, DFAS issued demand letters to contractors for \$175 million and collected about \$73 million as of November 1993. The firm also reported that approximately \$17 million of contractor debts may not be collectable for one or more reasons, including the bankruptcies of contractors who owed \$8 million.

DOD is currently considering a number of ways to strengthen existing internal control procedures designed to prevent overpayments and to more rapidly detect such payments when they occur. Also, initiatives are underway to reform and streamline the complex regulatory policies and procedures that affect contract payments. We will consider the effectiveness of these actions as part of our continuing work on contract overpayments for this Committee. As noted in following sections of this testimony, DOD's internal controls over disbursements have a number of shortcomings, including an increased risk of fraudulent payments. Because of the large dollar amounts at risk, DOD should view the need for corrective actions in this area with an increased sense of urgency.

WEAK CONTROLS PERMITTED
MILITARY SEALIFT COMMAND FRAUD

The overpayments to contractors I just discussed occurred and went undetected because existing controls were not effective. Control breakdowns have also contributed to fraudulent payments. The recent disclosures concerning \$3 million of false claims by a former Military Sealift Command supply officer clearly illustrate the devastating and costly effects that can result from internal control deficiencies. While the overall amount of the fraudulent payments in this case is certainly disturbing in itself, other circumstances surrounding this case may provide even more insight into the poor condition of a key portion of DOD's internal control structure.

In this case, a former supply officer of the Navy's Military Sealift Command, working primarily from outside Navy and DOD financial organizations, established a fictitious contracting company and received payments for over a hundred bogus invoices. Military Sealift Command personnel discovered his illegal activities after he submitted several invoices for large amounts for parts purportedly delivered to a decommissioned vessel. Had he not submitted relatively large dollar invoices related to a decommissioned vessel, he may have been able to continue to carry out his scheme.

At least three Navy and DOD activities were involved in reviewing and accounting for payments on 108 fraudulent invoices (and related bogus purchase orders) for ship parts that were neither ordered nor delivered. The former supply officer carried out his illegal scheme for almost 4 years without raising critical questions because controls were inadequate to ensure that (1) parts were ordered using authorized purchase orders, (2) parts were accepted by authorized Navy personnel, and (3) payment requests were valid. Also, the Military Sealift Command did not match individual disbursements with related obligations, another control procedure which may have triggered an investigation leading to the disclosure of this fraudulent scheme. If basic internal controls were in place, the fraudulent payment requests would--at a minimum--have

been identified sooner, thus saving millions of dollars. Basic controls are fundamental for any entity to ensure that payments it makes accurately correspond to goods and services actually received.

Another disturbing aspect of this case is that the fraudulent scheme was perpetrated in a relatively unsophisticated manner--the former supply officer with general knowledge of documentation requirements for contract payments, simply submitted bogus purchase orders and invoices which included fraudulent receipt and acceptance information. In fact, the perpetrator even incorrectly completed the documents on several occasions, and the Navy provided him instructions on how to prepare and submit "properly documented" invoices.

The relatively unsophisticated method used to perpetrate this fraud--like the case of the Air Force base accountant which I discussed at your hearing last July--illustrates just how weak DOD's disbursement controls are. Also, the fact that these cases were discovered by chance, and not through detection by internal controls, raises the possibility that more schemes may be ongoing and undetected. DOD officials have informed us that corrective actions intended to improve controls to prevent future occurrences of this sort are scheduled to be implemented by the end of this fiscal year. We will monitor these actions.

STATUS OF ACTIONS AND INVESTIGATIONS
RESULTING FROM IMPROPER ARMY PAYROLL PAYMENTS

In my July 1993 testimony before this Committee,⁴ as well as our related report on problems with Army's military payroll,⁵ I discussed an estimated \$6 million in unauthorized payroll payments. Since that time, we have been monitoring DFAS's efforts and working with the Army's Criminal Investigation Command (known as CID). CID is responsible for conducting criminal investigations involving Army personnel. As of March 1994, DFAS estimated that the amount owed the government as a result of improper military payroll payments was about \$7.8 million, or about 30 percent over the amount initially identified. Included in these amounts are payments to "ghost" soldiers and deserters.

Today, I will update you on progress of the ongoing efforts to (1) prosecute individuals in connection with improper payroll payments, (2) identify additional overpayments, (3) collect debts owed the government, and (4) correct control and system weaknesses. But I would caution that this situation is far from being resolved.

⁴(GAO/T-AIMD-93-1, July 1, 1993).

⁵Financial Management: Defense's System for Army Military Payroll Is Unreliable (GAO/AIMD-93-32, September 30, 1993).

Research to determine the total debt owed the government as a result of improper DOD payroll payments, as well as in each of the other areas I just mentioned, is still ongoing.

Results of Investigations

As of March 1994, investigations have shown that four individuals received payroll payments for six "ghost" soldiers, and 76 deserters from the Army were improperly paid. The "ghost" soldiers represent fictitious pay accounts fraudulently established by finance clerks manipulating the payroll system. To date, four individuals have been incarcerated, and prosecutions are pending on 10 other individuals.

Details on the circumstances surrounding 10 examples of fraudulent Army payroll payments are provided in attachment I. The following two examples provide a brief description of circumstances involving fraudulent Army payroll payments to a "ghost" soldier and a deserter.

- A finance clerk created a fictitious payroll account in the payroll system using a fabricated name and social security number and collected over \$71,000.
- Another soldier deserted in October 1991 yet continued to receive over \$43,000 in payroll payments through May 1993.

DFAS, either at its own initiative or in response to GAO requests, has begun identifying additional recipients of improper payroll payments. These cases are in various stages of analysis or investigation.

Actions to Recover Indebtedness

As of March 1994, DFAS records showed that collection efforts have recovered over \$1.7 million of the estimated \$7.8 million owed the government because of improper Army payroll payments. Approximately \$900,000 of this amount was recovered as a result of CID investigations. The remaining \$800,000 was recovered through DFAS's normal debt collection process.

In addition, DFAS determined that its debt management system did not include an estimated \$27.5 million in additional payroll debt not related to the identified overpayments. According to DFAS officials, this occurred because of a breakdown in the process of passing debt information from the payroll system to the debt management system. Because the debt had not been passed to the debt management system, DFAS could not initiate action to collect the \$27.5 million. Included in this amount was a final separation check incorrectly issued in the amount of \$836,919 instead of the correct amount of \$183. According to DFAS officials, DFAS now has procedures to (1) identify and validate all checks in excess of

\$6,000 before issuance and (2) ensure that the correct information is entered in the debt management system so that collection efforts can be initiated.

Status of Corrective Actions

To date we have identified a variety of causes for the breakdowns in payroll internal controls. We have also noted that the personnel and payroll systems were not integrated. Without an integrated personnel and payroll system, comparison of automated payroll and personnel files is a normally required control to detect improper or fraudulent payroll payments. To operate this control effectively requires cooperative action by both DFAS, which has responsibility for processing and accounting for payroll payments, and the Army, which has responsibility for authorizing and processing personnel actions that provide the basis for payroll payments. However, we found that this control was not in place at the time of our review. We have also found that Army personnel were not following established procedures, in particular requirements concerning timely submission of personnel actions.

DFAS efforts to date have focused on identifying and collecting debts owed the government as a result of improper Army payroll payments. According to DFAS officials, a number of other efforts are underway to improve controls and strengthen procedures in this area. In addition, we understand that the Army Audit Agency has included a review of controls over the payroll process as part of its audit of the Army's fiscal year 1993 financial statements and is expected to provide further insights into the underlying causes of these internal control breakdowns.

However, significant unresolved issues remain in this area. The integration of payroll and personnel systems will require a sustained commitment by both DFAS and Army leadership. In addition, DFAS and the Army must work cooperatively to ensure that both personnel and related payroll transactions are processed in accordance with established policies and procedures. It is also critical that planned corrective actions include analyzing and investigating the potential cases of payroll improprieties that remain with DFAS and CID, including the estimated 500 cases CID had pending investigation as of March 1994. Based on current resource levels and system access, a CID official estimated that 3 years would be required to complete investigations on the remaining cases.

BILLIONS OF DOLLARS OF DISBURSEMENTS CANNOT BE PROPERLY MATCHED TO OBLIGATIONS

Unmatched disbursements can have serious consequences. Tolerating their existence in large volumes can help hide the kinds of erroneous or illegal contractor payments I discussed previously.

In June 1993, we reported that as of December 19, 1992, one of the Navy's primary accounting systems contained \$13.6 billion of unmatched disbursements.⁶ Unmatched disbursements represent payments for goods and services which have not been matched with related obligations.

We found that Navy's unmatched disbursements were caused by a variety of problems, including lax compliance with internal controls over both the recording of obligations and disbursements and the detection and correction of identified errors. Not matching disbursements with obligations significantly increases the risk that fraudulent or erroneous payments may have occurred without being detected. In addition, unless disbursements are properly matched, agencies may not have the accurate information needed to ensure that cumulative amounts of disbursements do not exceed appropriation and other legal limits. In other reports, we have noted that the Army and Air Force also had significant problems in properly matching disbursements with obligations.⁷

In response to our work, DOD established a special team in July 1993 to address unmatched disbursements DOD-wide. Early on in its work, the team defined two general categories of disbursements--unmatched and undistributed--upon which to concentrate its efforts and to establish "benchmarks" for measuring its success in resolving disbursement problems. The team defined an unmatched disbursement as a disbursement which was not matched to a corresponding obligation because of an error, such as inaccurate or incomplete accounting data. These transactions were considered to be a problem.

The team defined an undistributed disbursement as a transaction that had not yet been through the matching process. The team did not view such transactions to be problem transactions because DOD had not yet made an attempt to match them to specific obligations. Instead, the team viewed these transactions as a normal consequence of the DOD disbursement process. However, the team did not have sufficient information on those disbursements to conclusively determine whether they represented problems. Such information would include the number, dollar amounts, and age of the transactions. The team indicated that when it got this type of information, it might reconsider whether or not undistributed disbursements are problem transactions.

⁶Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements (GAO/AFMD-93-21, June 9, 1993).

⁷Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, December 22, 1993) and Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

Using the two general categories, the team identified approximately \$41 billion of disbursements within DOD as of March 1993-- \$22 billion in undistributed or non-problem disbursements, and \$19 billion in unmatched or problem disbursements. As of January 1994, the team reported that its reconciliation efforts had reduced the amount of DOD's problem transactions from a DOD-wide total of \$19 billion in March 1993, to \$12.6 billion.

We are concerned about the team's general characterizations of disbursements. First, we are concerned with the team's view that undistributed disbursements were not a problem, because the data needed to make that determination was not available. Specifically, we believe that some undistributed disbursements may be problem transactions. For example, if disbursements are not promptly distributed to the accountable activity responsible for matching them to an obligation, then they may mislead financial and program managers about the actual value of outstanding obligations and the total amount of expenditures. As part of our ongoing work, we plan to analyze the undistributed accounts to determine how long they have been in the undistributed category.

Secondly, we do not believe that the team's definitions included all of the various types of disbursements that should have been considered as problem transactions. Our preliminary analysis of how the unmatched or problem transactions were identified and categorized disclosed that billions of dollars of problem transactions were either excluded from the \$41 billion universe of disbursement transactions or inaccurately reported. As a result, we believe the amount of problem transactions was probably significantly higher than both the \$19 billion initially identified by the team and the \$12.6 billion currently reported.

For example, we found that DFAS-Denver was not including billions of dollars of negative unliquidated obligations as problem disbursements.⁸ When DFAS-Denver determined the amount of negative unliquidated obligation balances, it combined the negative and positive unliquidated obligation balances on each contract to arrive at a net figure. For instance, if the contract had \$15 million of negative unliquidated obligations and \$5 million of positive unliquidated obligations, DFAS-Denver would net the two

⁸Transactions result in negative unliquidated obligations when recorded expenditures exceed recorded obligations. We have issued several reports on negative unliquidated obligations at DOD: Financial Management: Air Force Systems Command Is Unaware of Status of Negative Unliquidated Obligations (GAO/AFMD-91-42, August 29, 1991); Financial Management: Army Records Contain Millions of Dollars in Negative Unliquidated Obligations (GAO/AFMD-90-41, May 2, 1990); and Financial Management: Air Force Records Contain \$512 Million in Negative Unliquidated Obligations (GAO/AFMD-89-78, June 30, 1989).

balances and report \$10 million of problem disbursements for the contract. However, if the positive and negative values were reversed, no problem transactions would be reported for the contract since the net value of combining the positive and negative balances would produce a positive obligation balance of \$10 million. In both cases, the value of problem disbursements was \$20 million, and thus significantly understated.

Recognizing that reporting net obligation balances masks the true value of problem transactions, we requested that DFAS-Denver develop a special computer program to identify the absolute value of negative unliquidated obligations for each contract. This special run disclosed that as of March 1994, Denver's records contained about \$7 billion of negative unliquidated obligation balances or about \$6.4 billion more than it had previously reported in February 1994. DFAS-Denver officials acknowledged that reporting net amounts dramatically distorts the magnitude of the problem. The officials agreed with our position and have indicated that they will now require unliquidated obligations be reported as absolute values.

As this Committee has requested, we are beginning an assignment to monitor DOD's efforts and progress in resolving these disbursement problems. We will keep the Committee fully informed of the progress and effectiveness of DOD's actions. Because of the far-reaching nature of these problems, it is critical that DOD actions comprehensively focus on and address these problems.

DOD HAS CONTINUING PROBLEMS WITH "M" ACCOUNTS

We testified before this Committee last July that due to years of neglect, inadequate systems, and poor management, DOD could not properly implement provisions of the "M" account legislation (Public Law 101-510). For example, we pointed out that the Air Force did not have adequate controls over "M" accounts, and could not adequately document hundreds of millions of dollars in budget authority it restored to correct what it characterized as over 30 years of accounting errors. Unfortunately, DOD's problems with accurately accounting for and reporting on its "M" accounts continue.

On September 30, 1993, as required by law, DOD canceled \$3.1 billion in "M" account funds which represented the last remaining "M" account budget authority available for paying DOD's bills. Any future payments related to these canceled appropriations will have to be made from current year funds. In February 1994, we notified the Secretary of Defense that we had identified five DOD "M" accounts that, according to DOD financial reports, may have been

overexpended by \$152.7 million as of September 30, 1993.⁹ We pointed out that an expenditure or obligation in excess of an appropriation or fund balance violates the Antideficiency Act, and that any violation must be immediately reported to the President and the Congress. DOD has since informed us that the five appropriations may be overexpended, and we understand it is investigating whether Antideficiency Act violations have occurred.

LIMITED PROGRESS IN IMPLEMENTING DOD'S
FINANCIAL MANAGEMENT IMPROVEMENT INITIATIVES

DOD has had initiatives underway for several years that are intended to fundamentally change the structure used to support its administrative operations and financial systems. However, we have seen only limited progress in these initiatives since I testified before this Committee last July.

Initiatives such as the Defense Business Operations Fund and DFAS's efforts under the Corporate Information Management initiative, are intended to improve the effectiveness of DOD's financial management operations and to produce cost savings and other efficiencies. DOD has transferred much of the responsibility, authority, control, and resources for financial management operations and systems from the military services to the Office of the Secretary of Defense (OSD) through these initiatives. Management of the component funds, however, remains in the hands of the military services.

Need to Strengthen Management of the
Defense Business Operations Fund

In October 1991, OSD implemented the Defense Business Operations Fund, which consolidated the nine existing industrial and stock funds operated by the military services, DOD, DFAS, and several smaller DOD organizations. The Fund's primary goal is to focus the attention of all levels of management on the total costs of carrying out certain critical DOD business operations.

The Fund has a business relationship with its customers, primarily the military services, that is modeled after private sector business operations. DOD estimates that in fiscal year 1995, the Fund will generate revenues of about \$77 billion, equal to those of the world's largest corporations.

Since the Fund was first proposed in February 1991, we have monitored and evaluated its implementation and operation. We continue to support the Fund's underlying concepts. However, as we recently reported, DOD has not yet achieved the Fund's objectives because

⁹Letter to the Honorable William J. Perry, the Secretary of Defense (GAO/AIMD-94-84R, February 24, 1994).

- policies critical to the Fund's operations either were not developed or needed revision;
- financial reports were inaccurate; and
- the cost accounting systems were fragmented and costly to maintain and did not provide the cost information necessary for managers to better control costs.¹⁰

On September 24, 1993, the Deputy Secretary of Defense and the Secretaries of the Army, Navy, and Air Force approved the Defense Business Operations Fund Improvement Plan, which consists of 56 actions and 183 tasks aimed at improving the Fund's operations and addressing known deficiencies. We believe the plan offers a potentially useful blueprint for achieving the goals for which the Fund was established. However, achieving the necessary actions within the planned milestones will require strong commitment and the active support of senior OSD management and the military services. While we believe DOD's overall approach is a step in the right direction, we are concerned about the following issues.

- DOD currently estimates that at the end of fiscal year 1994, the Fund will have approximately \$1.7 billion in accumulated operating losses. According to DOD's pricing policy, future years' prices are to be adjusted to recover prior year losses. However, setting current prices to recover prior losses is inconsistent with a basic tenet of the Fund--that current year prices should reflect the actual cost incurred in providing that year's goods and services--and diminishes incentives to reduce the cost of the Fund's operations. Instead of this practice, we have previously recommended that DOD be required to justify recovering any prior year losses as part of the appropriation process.¹¹
- Because of persistent problems with the Fund's operations, we suggested in an October 1993 letter to the Deputy Secretary of Defense that DOD appoint a full-time Fund director to be responsible for overseeing the Fund's implementation and day-to-day operation.¹² In response to that letter, DOD stated that instead of a Fund director, it had appointed the DOD Comptroller to oversee the implementation of the Fund's improvement plan. The Comptroller chairs the Defense Business Operations Fund

¹⁰Financial Management: DOD's Efforts to Improve Operations of the Defense Business Operations Fund (GAO/T-AIMD/NSIAD-94-146, March 24, 1994).

¹¹(GAO/T-AIMD/NSIAD-94-146).

¹²Letter to the Deputy Secretary of Defense, (GAO/AIMD-94-7R, October 12, 1993).

Corporate Board. The Corporate Board is comprised of functional and financial senior executives who are to represent the interests of the Fund and its customers. This approach to managing the implementation of the Fund is similar to past approaches, which were not effective. Decisions were either not made promptly, or not always implemented. Responsibility and authority for actions were diffused. Consequently, we believe the Secretary of Defense needs to closely monitor the effectiveness of this management approach.

Strategic Planning for Financial Systems

Today we are releasing a report on our concerns with the implementation of OSD's Corporate Information Management (CIM) initiative.¹³ OSD began its CIM initiative in October 1989, with the goal of improving all of its business processes and information systems to promote greater efficiency in response to increasing budget pressures. The CIM program encompasses all DOD functional areas, such as material management, procurement, human resources, and finance. DFAS is responsible for implementing improvements in the business processes and information systems for the finance and accounting area.

The approach identified for implementing CIM requires both the streamlining of business processes and the development of modern information systems. DFAS's approach is to select and adapt as an interim step the best existing systems for use as "migratory"¹⁴ financial systems to be followed eventually by "target" systems.

We are concerned that while DFAS has made some progress in selecting and modifying financial migratory systems and developing target systems requirements, it does not have a comprehensive strategic information systems plan. We believe that such a plan is necessary to ensure that (1) the migratory finance and accounting systems are adapted and implemented in a coordinated fashion and (2) the migratory systems' implementation will facilitate the transition to streamlined, integrated target systems. This plan is also needed to incorporate business process reengineering activities and to ensure that target systems will include standard data elements.

¹³Defense Management: Stronger Support Needed for Corporate Information Management Initiative to Succeed (GAO/AIMD/NSIAD-94-101, April 12, 1994).

¹⁴Under its "migration strategy," DOD will select one (or more) of the existing systems in each functional area as a standard (migratory) system for all DOD entities with activities in that area.

DFAS officials have agreed that an overall plan is needed and have informed us that it is currently being drafted. We will continue to monitor the DFAS system integration and modernization effort and keep this Committee advised of its status.

STATUS OF DOD'S EFFORTS TO
IMPLEMENT CFO ACT REQUIREMENTS

In my view, the CFO Act, which was enacted under the leadership of this Committee, has focused attention on the improvements needed in DOD's financial management. DOD's implementation of the act has yielded a number of positive results. However, for an entity as large and complex as DOD, the full realization of all potential benefits will require a significant period of time. A summary of the status of DOD's implementation of the CFO Act is provided in attachment II. However, I would like to now briefly mention some highlights of financial audits done in DOD pursuant to the CFO Act.

- DFAS and the military services have made progress in preparing financial statements and the extensive related disclosures and supplemental information. The Department of the Army has demonstrated proactive involvement from top management officials in resolving financial problems disclosed by the audits.
- The CFO Act audits have provided overwhelming evidence of the need to deal with widespread and severe financial management weaknesses. They have identified billions of dollars of erroneous disbursements, waste, mismanagement, fraud, and misappropriation. Calling attention to such problems is a necessary and significant "first step" in devising and implementing actions to improve financial management systems, operations, and controls.
- Implementation of the CFO Act has brought about some improvements in the extent, quality, and timing of financial information available to congressional decisionmakers and DOD managers. For example, the Army established quality assurance processes to ensure that management information in its real property system is more accurate. These processes are intended to enhance the reliability of future budget requests and information used in the base closure and realignment reviews.
- In certain instances, opportunities to make short-term improvements to financial management systems and controls have been identified. Audits conducted at Army, Air Force, Navy, and DFAS organizations highlighted the importance and necessity of solving the serious problem of unmatched disbursements. The audits prompted DOD officials acknowledge unmatched disbursements as a material weakness.
- DOD audit organizations have devoted substantial efforts and resources to conducting the audits required by the CFO Act.

Over the past few years, hundreds of DOD auditors have been formally trained in conducting financial audits while others received on-the-job training by working on financial audits. I would like to commend the DOD audit community--the Inspector General, Air Force Audit Agency, Army Audit Agency, and Naval Audit Service--for their commitment and efforts to carry out the audit responsibilities mandated by the act.

In addition, as I discussed in previous testimonies before this Committee, the CFO Act provides a blueprint for essential financial management reforms, such as those proposed by the Administration's National Performance Review and the Government Performance and Results Act of 1993. Specifically, the perspective obtained through annual agency financial reports under the CFO Act is consistent with the annual report on the government's finances called for by the National Performance Review. Annual CFO Act audits also provide an important vehicle for monitoring the DOD efforts to resolve the weaknesses I discussed today.

MORE FORTHRIGHT ACKNOWLEDGEMENT OF FINANCIAL MANAGEMENT PROBLEMS

In the past, we have been highly critical of DOD's failure to acknowledge the fundamental and pervasive internal control, financial system, and accounting problems in many critical areas of its operations. Most recently, I expressed such concerns in an April 1993 letter to former Defense Secretary Aspin.¹⁵ In that letter, I took exception to the Secretary's fiscal year 1992 reporting pursuant to the Federal Managers' Financial Integrity Act. The Secretary's report concluded that, overall, the DOD's controls and accounting systems provided reasonable assurance that the goals of the act were being achieved. I pointed out that the report's conclusion was inconsistent with the litany of internal control and accounting system weaknesses discussed in the details of his report and with the findings presented in numerous audit reports. In this respect, I noted that GAO and other auditors' reports had highlighted long-standing management, internal control, and accounting system deficiencies that weakened DOD's ability to safeguard, manage, and control the hundreds of billions of dollars of resources entrusted to it.

While I still have some concerns with aspects of DOD's reporting, its latest annual Federal Managers' Financial Integrity Act report to the President and the Congress is much more candid than previous reports. Specifically, the Secretary's fiscal year 1993 report acknowledges 58 additional material weaknesses--many in critical areas of DOD's operations. For example, DOD now acknowledges material weaknesses in

¹⁵Letter to the Honorable Les Aspin, the Secretary of Defense, (GAO/AFMD-93-61R, April 27, 1993).

- obtaining reliable information on its major equipment items that is needed to determine maintenance requirements and redistribute equipment,
- ensuring that Army Reserve personnel do not receive duplicate salary payments,
- controlling access to its automated systems, and
- providing adequate contingency plans specifying actions needed in the event of catastrophic events at its major data processing centers.

Also encouraging are DOD's frank admissions in the former Secretary's annual management report to the President and the Congress.¹⁶ In the report, the Secretary acknowledges that financial management complacency has permitted pervasive and harmful weaknesses in DOD financial management operations. The report also describes adverse consequences that resulted from these weaknesses and recognizes that the waste these weaknesses cause reduces combat capability and damages the DOD's credibility with the public and the Congress. Specifically, the report recognizes the following:

Accounting, business-type efficiency, and indirect support functions were secondary considerations of top DOD leaders. Now, however, this limited attention to financial management threatens U.S. combat power in two ways: (1) financial management problems waste money that is needed more than ever to sustain sufficient combat power and (2) whenever mismanagement surfaces, understandable congressional and public response is to often reduce overall DOD spending by more than would otherwise be the case.

The [DOD] financial management community adapted to shortcomings and lacked a sense of urgency for correcting them. Senior DOD leaders did not consider financial management shortcomings as serious as those in other areas.

The [DOD] has serious, long-standing financial management problems. If DOD does not candidly acknowledge that reality, it cannot expect support in solving those problems and confidence in the overall stewardship of defense matters will be undermined.

With these forthright admissions of serious weaknesses, DOD--for the first time--is in a better position to comprehensively and realistically address them.

¹⁶Annual Report to the President and the Congress, Les Aspin, Secretary of Defense, January 1994.

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Mr. Chairman, DOD has had serious financial management problems for decades. The problem areas I discussed today are representative of the problems DOD has been facing for years. It is important to recognize that turning this situation around will be a daunting and formidable challenge. Most importantly, strong sustained support and commitment by DOD's top leadership and its managers at all levels will be required.

DOD has now taken the first step to making these fundamental changes. The new DOD leadership's recent recognition of serious problems, as well as their heightened interest in bringing about the resolution of these problems is encouraging.

However, translating this acknowledgement into needed actions will require not only sustained management commitment, but also the requisite investment in people and systems. Cost awareness and reliable financial reporting must become ingrained in DOD's management culture. I look forward to working with the new leadership in DOD, as well as with this Committee, as we strive to achieve our mutual goal of a better managed and fully accountable Department of Defense. This Committee's continuing oversight has been instrumental in helping focus DOD leadership's attention on critical financial management areas in need of improvement. Such oversight will continue to be an essential element in assuring the prompt, effective resolution of the fundamental financial management weaknesses facing DOD.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions you or other Members of the Committee may have.

EXAMPLES OF CASES IDENTIFIED AS IMPROPER PAYROLL PAYMENTSExample 1

An Army finance clerk created two fictitious pay accounts with allotments transferring approximately \$100,000 in pay to the clerk's bank accounts. To create one of the fictitious pay accounts, the finance clerk manipulated the pay system to create a fictitious soldier ("ghost"). The second fictitious account was established by reactivating the pay account of a private that separated from the Army in December 1990.

After creating the "ghost" account, the finance clerk manipulated the pay system to show that the "ghost" soldier had deployed to southwest Asia, thereby becoming eligible for additional payments for hostile fire pay, foreign duty pay, and family separation pay. The pay system was further manipulated to have the pay for the fictitious soldier forwarded to financial institutions in Virginia and North Carolina where the finance clerk had accounts.

Following the bogus reactivation of the separated soldier, the finance clerk promoted the "ghost" soldier six ranks to a sergeant first class and had the pay electronically transmitted to the clerk's bank accounts at a credit union in Indianapolis, IN.

Actions are underway to freeze \$22,000 of assets which remain in the finance clerk's bank accounts. In addition, the Staff Judge Advocate Office has filed criminal charges against the clerk with preliminary hearings scheduled to begin later this month.

Example 2

In August 1992, a finance clerk manipulated the payroll system by establishing pay accounts for two fictitious soldiers. Over \$33,000 in payroll payments for these two "ghosts" were electronically submitted to the clerk's bank account in Germany. In a statement to investigators, the finance clerk claimed that the documents used to create these fictitious accounts were initially submitted to the finance office as a test of the improved internal controls in the newly implemented payroll system, and the clerk forgot to stop the test after the false accounts were established in the system and funds diverted to the finance clerk's bank account. However, the clerk's supervisor was not aware of any such test being performed by the finance clerk. The Staff Judge Advocate Office initiated proceedings for criminal prosecution charging the finance clerk with larceny and fraud.

Example 3

In December 1991, a finance clerk generated documents to establish a pay account for a "ghost" soldier using a fabricated name and social security number. Rather than manipulate the payroll system directly, the finance clerk signed the bogus documents as the authorizing official and submitted them for normal processing. This resulted in the establishment of the "ghost" soldier's pay account. The finance clerk directed a \$700 monthly allotment to his bank account in Georgia. However, the remainder of the pay was being held at DFAS because the manipulated records showed the "ghost" soldier to be in southwest Asia.

In January 1993, the clerk increased the allotment to \$1,500 per month. Meanwhile, he falsified documents to release \$14,000 which had been held by DFAS. In addition, prior to receiving the \$14,000, the clerk falsified another document to authorize an \$8,000 advance against the "ghost" soldier's pay which was also sent to the clerk's bank account. Overall, the finance clerk received over \$71,000 in payroll payments.

The finance clerk was court martialed, sentenced to 6 months in confinement, and reduced in rank from a specialist to a private.

Example 4

A finance clerk obtained a list of separated soldiers from the payroll system and reactivated a former soldier's pay account with pay disbursements deposited directly to his account at a financial institution in New Hampshire. In addition, the clerk directed a \$750 monthly allotment to a relative in Florida.

The clerk further manipulated the pay system and placed the re-established "ghost" account in a permanent change-of-station status. This action prevents the delivery of monthly leave and earnings statements--a primary DFAS internal control established to prevent payroll overpayments. Finally, he promoted the reactivated "ghost" soldier and extended his enlistment until 1997. Over \$8,600 was paid to the "ghost" account before pay was suspended.

In December 1993, the clerk was court martialed, reduced to a private, fined \$2,300, and received a bad conduct discharge. Debt collection efforts are under way at DFAS.

Example 5

In October 1991, a sergeant first class did not return to his unit after being assigned to a temporary work location. The soldier was known to be a deserter by his unit in December 1991. However,

because the unit failed to report the desertion to the personnel office, the soldier continued to receive full pay through May 1993. Improper payments totalling over \$43,000 were deposited directly to a midwest bank. The soldier was apprehended in October 1993. In January 1994, the soldier received an other than honorable discharge. The case has been referred to the U.S. Attorney's office in Illinois.

Example 6

From July to November 1991, a reserve major served on active duty in response to Desert Shield/Desert Storm. However, DFAS continued to send electronic pay deposits to a northeastern financial institution through April 1993, resulting in approximately \$88,000 in overpayments. Since the official separation documents were not forwarded to DFAS, the soldier's pay continued until our audit surfaced the situation in April 1993.

After being contacted by DFAS officials, the officer agreed to repay the government, even though he had already spent the funds. Criminal prosecution is under consideration by the U.S. Attorney's office in New York.

Example 7

After a period of active duty, a sergeant major reservist separated from the Army in February 1992, yet continued to be paid through May 1993. Apparently, the soldier's official separation papers were not processed properly and the soldier's pay was continued. After separation, the reservist improperly received approximately \$46,000 in payments which were directly deposited to her bank account in a financial institution in Pennsylvania.

The U.S. Attorney's office in Pennsylvania declined criminal prosecution and DFAS is attempting to collect the debt.

Example 8

A reserve major entered active duty for two days during July 1991. After separation, the officer was not removed from the active payroll. The separated officer continued to receive pay through July 1993 when the overpayment was surfaced by our audit. During part of this period, he also collected reserve pay.

In addition, in November 1991, the officer received an additional pay transfer under a second social security number which DFAS officials are currently unable to explain. The officer's total debt is approximately \$149,000, plus penalties and interest.

CID investigated this case and is referring it to the U. S. Attorney's office.

Example 9

In July 1992 a reserve major separated from active duty service, yet continued to receive over \$51,000 in active duty pay through August 1993. During this 12 month period, the major also received pay for reserve drills. Facts pertaining to this case are still being developed, and the U.S. Attorney's office is considering criminal prosecution.

Example 10

A specialist separated from the Army in March 1991 and was entitled to separation pay of \$183.69 for accumulated leave. In June 1992, DFAS erroneously issued a final separation check of \$836,919.19, which according to DFAS officials was due to incorrect posting of entered data and lack of validation procedures prior to check issuance. From those funds, the former soldier invested \$300,000 in stocks and bonds, paid a relative's debts of \$200,000, placed \$100,000 in a savings account at a Missouri financial institution in order to purchase a house, and allegedly gave the rest to charitable organizations. The U. S. Attorney's office initially filed a civil complaint, however the individual attempted to conceal some of these assets before they could be recovered. Criminal charges are now pending.

DEPARTMENT OF DEFENSE'S IMPLEMENTATION OF
THE CHIEF FINANCIAL OFFICERS ACT

The Chief Financial Officers Act of 1990 (P.L. 101-576) requires that a Chief Financial Officer (CFO) be established within the Department of Defense (DOD) to carry out the responsibilities and functions delineated by the statute. Also, the act stipulates that the financial operations of DOD's various revolving and trust funds, as well as DOD activities performing substantial commercial functions, be audited on an annual basis. The act further specifies that the Army and the Air Force participate in a pilot project requiring them to prepare and have audited their consolidated financial statements.¹

The financial audits which have been conducted pursuant to the CFO Act have provided overwhelming evidence of widespread and severe financial weaknesses requiring sharply increased emphasis and attention by DOD financial managers. The various audits have identified billions of dollars of erroneous disbursements, waste, mismanagement, misappropriation, fraud, and potential monetary benefits within DOD. In addition, the audits disclosed dozens of material internal control weaknesses and financial management systems deficiencies. These problems are so severe and prevalent within the Department that of the 35 financial statements audited during fiscal years 1991 and 1992, only 3--the Foreign Military Loan Liquidating Account, the DOD Military Retirement Trust Fund, and the National Security Education Trust Fund--received unqualified opinions. In fact, most of the financial statements have been deemed to be unauditible by the various audit organizations, clearly indicating that vast improvements and enhanced discipline are urgently needed in DOD's financial controls, systems, and operations.

The underlying themes arising from the various audits are the inability of many current systems to produce reliable and verifiable financial data, and the failure of personnel to follow established policies, procedures, and regulations. Many of the systems are the source of critical data for Office of Management and Budget and congressional considerations during budgetary preparations and deliberations. The required improvements in DOD's

¹The Army was required to prepare and have audited its fiscal years 1991 and 1992 financial statements while the Air Force was required to prepare and have audited its fiscal year 1992 financial statements.

financial management systems, if properly implemented, will substantially fulfill one of the Act's primary objectives-- improving systems of accounting, financial management, and internal control.

DOD's implementation of the CFO Act has begun to yield a number of positive benefits and results. The results and findings of the CFO Act-mandated audits provide one of the primary bases for initiating financial management improvements within DOD. The overall accuracy and reliability of some DOD organizations' financial records have improved, more reliable information is being made available for management and congressional decision-making, some improvements to financial systems and internal controls have resulted, and financial savings and budgetary benefits have been realized. However, for an entity as large and complex as DOD, the full realization of all potential benefits will require more than several years.

The CFO Act has also served to increase DOD top managers' interest in financial management. Senior DOD management officials have stated that the resolution of financial management problems is now receiving high-level management attention. One military department, the Army, has achieved proactive, visible involvement from top management officials in resolving financial problems disclosed by the audits. Based on our discussions and briefings on the results of our fiscal year 1991 audit, the Army established a special action group directed by senior civilian and military managers to oversee implementation of corrective actions. However, in certain instances, DOD organizations have been slow to address serious deficiencies, thereby hampering effective financial management. For example, only in mid fiscal year 1993 did the Air Force and DFAS develop a financial management plan aimed at addressing deficiencies in the Air Force's financial systems and controls that we initially reported in February 1990.

FINANCIAL STATEMENTS ISSUED AND AUDIT RESULTS

Pursuant to the requirements of the CFO Act, DOD organizations prepared 7 financial statements during fiscal year 1991 and 28 during fiscal year 1992. GAO and the DOD Inspector General (with the assistance of the military services' audit agencies) conducted financial audits of these 35 statements. The financial statements prepared and audited during fiscal year 1992 encompassed approximately 66 and 80 percent of the total assets and revenues (including appropriated funds) controlled by DOD. The largest DOD component not subject to audit under the CFO Act is the Navy.

Should financial audit requirements be extended to include the Navy, audit coverage of DOD entities would approach 100 percent.

Additionally, while each statement was audited, some of the audits, for various reasons, only covered certain accounts or financial statement line items. The audits' findings resulted in the issuance of 21 disclaimers, 8 adverse opinions, 5 qualified opinions, and 3 unqualified opinions. This highlights the magnitude of the problems and indicates that improvements are urgently needed in DOD's financial controls, systems, and operations. The following table presents the type and number of opinions received within each of the military organizations by fiscal year.

Table 1: Summary of Types of Reports Issued as a Result of Financial Audits Performed Pursuant to the CFO Act

<u>Opinion Received*</u>	<u>DOD</u>	<u>Army</u>	<u>Air Force</u>	<u>Totals+</u>
Unqualified				
FY 1991	0	0	0	0
FY 1992	3	0	0	3
Qualified				
FY 1991	3	0	0	3
FY 1992	2	0	0	2
Adverse				
FY 1991	2	0	0	2
FY 1992	6	0	0	6
Disclaimer				
FY 1991	1	1	0	2
FY 1992	17	1	1	19

* An unqualified opinion states that the financial statements are presented fairly in conformity with generally accepted accounting principles (GAAP). A qualified opinion states that, except for the matter to which the qualification relates, the financial statements are fairly presented in conformity with GAAP. An adverse opinion states that the financial statements are not presented fairly in conformity with GAAP. A disclaimer of opinion states that the auditor does not express an opinion on the financial statements. A disclaimer of opinion is issued when the auditor has been unable to perform an audit of sufficient scope to enable the auditor to form an opinion on the financial statements.

+ Thirty-seven opinions were issued on 35 financial statements audited because the Naval Audit Service in its audits of the Navy's

Defense Business Operations Fund activities issued opinions on various accounts/line items rather than on the financial statements taken as a whole.

BENEFITS RESULTING FROM FINANCIAL AUDITS

As discussed in the following sections, actions taken by DOD entities as a result of findings from CFO Act-mandated audits have already produced various benefits, including enhanced information for decisionmakers, improved systems and controls, and realized and potential financial savings.

Actions to Improve Information for Management Decisionmaking

One primary role of financial management is to provide DOD managers--especially program managers--the financial information needed to better manage activities and programs on a day-to-day basis. DOD organizations, which are among the largest and most complex in the world, require the highest quality and most timely information available in order to (1) operate efficiently, (2) effectively fulfill their missions, and (3) ultimately ensure that our national security interests are preserved. As a result of CFO Act-mandated audits, DOD has initiated actions to correct identified weaknesses in internal controls. Those weaknesses have forced managers to rely on inadequate, inaccurate, and incomplete information in making program and operating decisions. Following are examples of completed and ongoing improvements in the quality of information provided to decisionmakers.

- The Army established quality assurance processes to ensure that management information in its real property system is more accurate, thereby enhancing the reliability of future budget requests and avoiding performance of additional validation reviews of data required by the Defense Base Closure and Realignment Commission.
- DOD re-emphasized the need to conduct physical inventories, in order to (1) improve controls over materiel inventories at depots, (2) provide assurance that unnecessary purchases are avoided, and (3) to ensure that materiel issued is actually used and/or charged to the correct maintenance jobs. Further, the Army has actions underway to strengthen data input procedures to the system used to account for and control repairables to ensure maintenance work and cost is accurately recorded to individual jobs. In addition, the Defense

Logistics Agency plans to implement an inventory program requiring physical inventories of items which have been requested but issuance denied due to item outages.

- An estimated \$18 billion in potential liabilities associated with hazardous waste disposals at Army installations were disclosed by CFO Act-mandated audits of the Department of the Army.
- The Corps of Engineers initiated a detailed analysis and reconciliation of its construction-in-progress account to purge completed projects and determine whether such projects were properly accounted for in the financial records. While completed projects have been removed from the construction-in-progress account as a result of this effort, many more remain, and the Corps continues to conduct this analysis and reconciliation on an annual basis.
- Approximately \$128 billion in adjustments were recorded to improve the accuracy of Army commands' financial records.

Actions to Strengthen Systems and Controls

DOD organizations have a long-standing history of widespread and serious control weaknesses within their financial management systems. Such weaknesses hamper efficient and effective management of operations. Audits conducted under the CFO Act during fiscal years 1991 and 1992 have led management to strengthen controls. Also, managers have been provided a better understanding of deficiencies for which they can implement corrective actions, thereby enhancing systems and controls. For example:

- The fiscal year 1991 audit of Army's financial operations found that billions of dollars of weapons and equipment awaiting repair and overhaul at maintenance depots were not adequately stored to prevent extensive corrosion which directly resulted in repair cost overruns. Since we reported the problem, DOD relocated these assets to more protective environments and Defense Logistics Agency personnel are now reviewing all storage decisions to ensure that expensive, fragile, and highly corrodible items are protected against the elements.
- Audits conducted at Army, Air Force, and Defense Finance and Accounting Service organizations highlighted the importance and necessity of solving the serious problem of unmatched disbursements. The audits prompted DOD to develop a plan to

eliminate systemic causes which led to billion of dollars of unmatched disbursements and to establish a task force to research and resolve existing unmatched disbursements.

- Findings from the fiscal year 1992 Army financial audit prompted the Army's Criminal Investigation Command to conduct investigations of potential payroll improprieties. In addition, it was determined that the DFAS-Indianapolis Center's debt management system was not operating effectively and, as a result, approximately \$27.5 million of payroll debts resulting from employee separations were not included.
- Our audit of the Army's fiscal year 1992 financial statements revealed that accounting records documenting individual transactions posted by subordinate commands of the Army Materiel Command, which are necessary to support balances in the budget execution system, were not retained. According to Army officials, as of October 1, 1992, records for all transactions are being retained.
- As a result of our audits of Army's financial systems and operations, the Office of the Deputy Chief of Staff for Logistics informed us that actions were being initiated to improve the accuracy of data recorded in Army's central logistics system for reporting the types, quantities, and locations of equipment. In addition, the system was included as a special interest item in the Command Logistics Review Program.

Realized and Potential Financial Savings

Making the most effective and efficient use of available resources is paramount in today's environment of constrained budgets. Audits conducted of the military services over the last several years have revealed that budgetary resources are not always adequately controlled and, at times, are inappropriately used. The audits have directly led to the recoupment of millions of dollars from contractors, as well as millions of dollars of potential budget reductions. In addition, further savings could be realized if DOD organizations and the military services complete actions necessary to strengthen internal controls and fully implement the act's requirements. Following are examples of both realized and potential financial savings resulting from CFO Act-mandated audits or financially-related audits.

- The DOD Inspector General has reported \$576.6 million of potential savings, \$35.4 million of recoveries, and \$200.8 million of resources used more efficiently as a direct result

of CFO Act-mandated financial statement audits conducted by Defense audit organizations.

- Audits of the Army determined that overpayments had been made to the services' contractors who had returned \$751 million by the first half of fiscal year 1993.
- The Naval Audit Service reported that its audit of the Navy's fiscal year 1992 DBOF operations disclosed numerous deficiencies and areas of potential improvements, which if corrective actions were taken, could result in potential monetary benefits of almost \$3.3 billion. For example, the audit service identified potential budget reductions of \$30.7 million related to understated inventories (thereby causing requirements to be overstated) and more efficient use of \$78.3 million which could result from the disposal of excess stocks.
- The Army financial audits identified \$7.8 million in payroll payments made to unauthorized personnel. The Army has initiated efforts to collect these overpayments and as of March 1994, \$1.7 million had been successfully collected.

Data Provided to the
Congress Not Reliable

The Congress requires financial and programmatic information from DOD organizations in order to assess mission performance and to make funding and other decisions affecting DOD programs and operations. These decisions are often based upon data derived from financial management systems, which are included in the scope of audits conducted pursuant to the CFO Act. Therefore, when such audits find information in these systems to be unreliable, it can be construed that reports and justification documents used in congressional oversight and decisionmaking will also be unreliable, thereby impairing the Congress' ability to make fully informed decisions. Following are examples of data provided to Congress in support of budgetary requests for which financial audits disclosed questions regarding the data's reliability:

- A CFO Act-mandated audit of the Army noted that fiscal year 1993 budget justification data was unreliable because information supporting the amounts requested for real property maintenance was developed from erroneous data in the real property systems.
- The reliability of data used to support DOD's budget requests for certain readiness-related activities is questionable. GAO's financial audits of the Army revealed that cost factors

used to support the requests, such as flying hours (for aircraft) and square footage (for buildings and facilities), did not always include all relevant or accurate costs, such as administrative expenses and pilot salaries.

- The Defense Business Operations Fund, which annually generates approximately \$77 billion in revenues, is supposed to bill its customers--primarily the military services--for the full cost of goods and services provided, including administrative and operating expenses. Congress in turn appropriates funds to the military services to pay for these costs. Audits have found, and the then DOD Acting Comptroller acknowledged, that the Fund's current accounting systems are not adequate--they cannot provide complete and reliable financial data, including the cost of goods provided and services rendered. Therefore, the Fund cannot be assured that it is recouping all of its costs, or that it is charging its customers for only the costs incurred.
- Some weapon systems cost information provided to the Congress to support critical funding decisions is questionable. A CFO Act-mandated audit of the Army found that cost data was incomplete and inconsistent for various weapon systems, such as Black Hawk helicopters.

COSTS OF PREPARING AND AUDITING DOD'S FINANCIAL STATEMENTS

Costs to prepare and audit DOD financial statements are significant; but the resulting benefits and improvements clearly show the investment to be worthwhile. According to the DOD Inspector General, DOD organizations spent \$2.9 million in preparing fiscal years 1991 and 1992 financial statements and the federal audit community expended approximately \$46.5 million auditing the statements. While the costs of financial statement preparation and the audits, are significant, the costs are relatively low given the size and volume of operations conducted by the entities being audited. To date, the costs of the audits, in most cases, have been less than one-hundredth of one percent of the total assets or total expenses reported in the entities' financial statements.

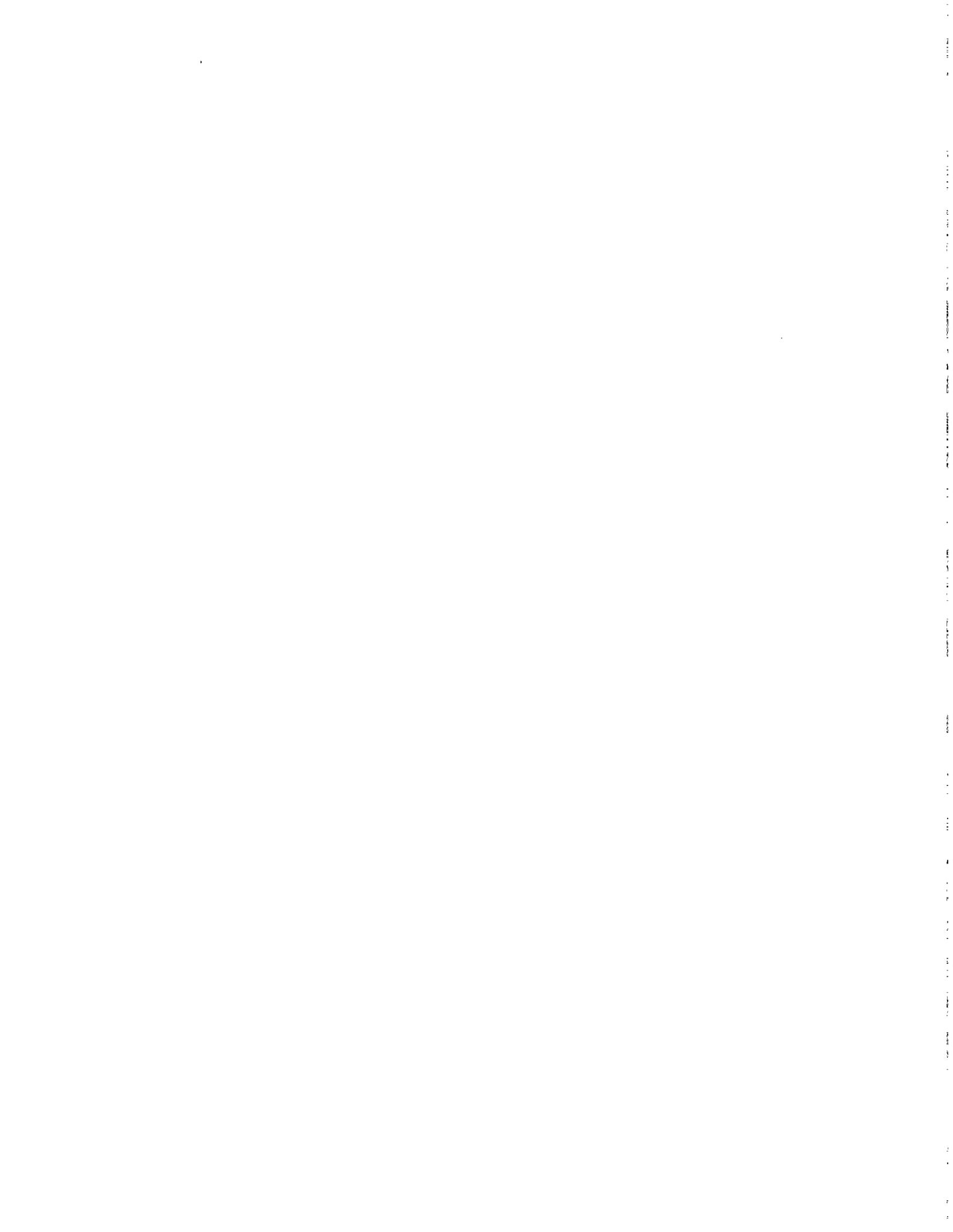
As the DOD audit organizations obtain more experience in performing financial audits and as the military services and DFAS obtain more experience in preparing financial statements, the associated costs should significantly decrease. In addition to the costs being small in comparison to the assets and expenses covered, they are greatly outweighed by the financial recoveries, potential

recoveries, and benefits resulting from the audits discussed previously.

The DOD Inspector General, for example, has reported the recovery of millions of dollars as a result of the CFO Act-mandated audits conducted by his organization. In its Semiannual Report to the Congress (April 1, 1993 to September 30, 1993), the DOD Inspector General reported that fiscal year 1992 financial statement audits conducted by Defense audit organizations identified potential savings of \$576.6 million, recoveries of \$35.4 million, and better use of \$200.8 million in resources. These total monetary benefits were more than 30 times the cost of the audits.

DOD audit organizations performed most of the audits of DOD entities and, therefore, incurred the most substantial costs. The CFO Act requires that the financial statements of DOD's pilot agencies--the Army and Air Force--and its revolving and trust funds be audited by the Inspector General, an independent external auditor as determined by the Inspector General, or the Comptroller General. To help carry out its audit responsibilities, the DOD Inspector General designated individual services' audit organizations to perform some of the audits. The fiscal year 1992 financial audits of the Defense Business Operations Fund and the fiscal year 1991 audits of several other smaller revolving and trust funds, were performed by the DOD Inspector General, the Army Audit Agency, the Air Force Audit Agency, and the Navy Audit Service. In addition, the Air Force Audit Agency audited the Air Force's consolidated fiscal year 1992 financial statements, while GAO, with assistance from Army Audit Agency and Navy Audit Service, and DOD Inspector General audited the Army's fiscal years 1991 and 1992 financial statements.

The DOD audit agencies have been strongly committed to train their staff in conducting financial audits. Through 1993, over 600 DOD auditors had attended GAO's financial audit training classes. Other DOD auditors received on-the-job training by working with GAO on the Army financial audits. Army Audit Agency staff assisted GAO on the fiscal years 1991 and 1992 Army audits while DOD Inspector General and Naval Audit Service auditors worked on the 1991 audit.



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